Insurance protection gaps

1. The figures for losses due to climatic events and cyber-attacks are alarming, and they are increasing all the time

1.1 Climate-related losses: dozens of billions of losses yearly, of which 70% are not insured

An industry representative explained that there have been roughly $260 billions of economic losses from natural catastrophes during 2023. Of this, over $100 billion was insured, and it was the fourth consecutive year of insured losses greater than $100 billion. $100 billion represents around 40% of $260 billion, so this amounts to an insurance gap of around 60%, which compares favourably to a gap that is typically about 70%. The biggest insured loss was from the earthquake in Turkey and Syria, at around $6 billion. However, there were also notable climate-related losses, as last year for the first time they reached about $60 billion from severe convective storms. This is almost double the amount that has been recorded on average over the last 10 years. It is concerning that, over the last 30 years, there has been an annual increase of 7% from these types of events.

The floods in Italy and New Zealand, Hurricane Otis in Mexico and the wildfires in Hawaii all resulted in record insured losses. When looking at Europe for a few additional data points, the average expected uninsured loss for a country such as Italy is around $5-6 billion each year, for Germany it is around $2 3 billion, and for Belgium it is $0.5-1 billion. The gap is increasing.

1.2 The intensity and the frequency of cyberattack risk are unknown, but the figures are concerning.

The Chair commented that the economic losses pose a risk to financial stability if they are not dealt with.

An official provided a breakdown of France's cyberattack costs in 2022. This covered a direct cost of €887 million, ransom payments of €888 million and production losses equivalent to €252 million. In the last finalised numbers for 2020 and 2021, cyberattacks accounted for around €200 million damage to just the financial sector. Since then, it has only grown. Economic damages caused globally by cybercrime rose from $3 trillion in 2015 to $6 trillion in 2021, with the potential to reach $10.5 trillion annually by 2025.

This is harder to calculate and to plan for because the intensity and the frequency is unknown and there is so little experience of these risks. The risk and the intensity of cyberattacks has kept growing in the last few years. There is an insurance gap there because only large companies are taking this very seriously and it is most of them which have insurance on this. The level of coverage is around 98% of large companies but much lower for small and medium sized enterprises (SMEs). For small companies, it is around 0%.

1.3 The impact is compounded in developed economies

The Chair summarised that it is not only the data that is coming in on natural catastrophes (nat. cats) that is concerning, but the increased data in relation to cyber.

An official stated that more attention is being paid to insurance due to climate change and novelties like digitalisation making events more dramatic. A recent analysis in the US reported that, in just 2023, there were 28 strictly weather-related disasters that alone resulted in losses of more than $1 billion. For comparison, between 2000 and 2009 there was an average of only seven such episodes per year.

As well as climate-related insurance, there is also cyber insurance. In the geopolitical context of the last years there is increasing concern over cyber-attacks related to cyber warfare.

1.4 Broader insurance coverage limits economic contraction and accelerates recovery post-disaster and dampens the impact on public finances

An official noted that a recent article in the Economist addressed how ransomware can not only cripple companies but also countries. Insurance markets are critical to helping fund the rebuild of a damaged property and the rebuild of lost revenues and income. A higher level of insurance or reinsurance coverage for disaster risk shows three things: a smaller contraction in economic activity, faster post-disaster recovery and more limited impact on public finances.

It is important for everyone to push for a higher level of coverage, especially to avoid insurance and reinsurance either becoming unavailable or unaffordable. In California, three out of the 10 largest US property and casualty insurance companies simply withdrew from the market in 2023. In Australia, households highly exposed to flood risk faced insurance premiums increases that exceeded 50%. The issue needs to be tackled.

2. Possible risk quantification and mutualisation challenges, and the wide range of protection gaps may reduce the insurability of certain of these risks, limiting the insurance sector's room of manoeuvre and affecting citizens' trust in the insurance sector

An official commented that, whereas climate-related losses tend to relate to higher frequency or high-intensity events, cyber tends to relate to new risks.

An industry representative commented these developments in cyber risk and stated that there are limits to insurability of risks. An insurance organisation aims for a diversification of risk and an understanding of the concentration of risk. There are then limits to concentration exposure, affordability and what makes sense to insure in terms of its nature.

Systemic risk tends to be thought of in two ways. If there is something that can be modelled, and if an expected loss scenario can be quantified, then that would be quantifiable and acceptable for an insurer. Even within systemic exposures, things such as malware can still be quantified; it is a quantifiable systemic risk. However, there are things like cyber terrorism or cyber warfare which are unquantifiable systemic risks. It is not something that is transferable from a risk perspective to the insurance industry.

The industry establishes trust by being clear on what is being done and what is being offered. There needs to be increased education in risk awareness, and at the same time, addressing behavioural bias and affordability. The ultimate focus is on loss prevention and increasing resilience.

3. The industry is shifting from an indemnification focus to risk prevention and awareness

The Chair stated that insurers can play a role in building resilience, mitigation, and adaptation.

An industry representative commented that the industry is shifting from focusing on indemnification to risk prevention and risk awareness. A great deal can be done on both nat. cat risk and cyber risk. When it comes to nat. cats, the insurance industry has decades worth of understanding and of modelling the risks. This expertise and insight can not only be provided to public authorities but also to the public to steer collective behaviour and help to mitigate the risks.

The insurance industry has much less experience and much less data to enable it to quantify cyber risks. However, the insurance industry is in the business of risk management and risk mitigation, so even though the models are not yet at the required level, the industry has identified ways to strongly reduce the risk.

The Chair summarised that it is essential to adapt because it will at least ensure that the number does not go up as high as it otherwise could.

An industry representative stated that there can no longer be a standalone conversation on developing new insurance schemes and increasing insurance penetration. It needs to be held in the context of how the industry can reduce risk at the same time.

4. The role of supervisors is evolving in order to better combine financial stability, risk prevention and insurance coverage development in the context of raising risks

A regulator and the Chair of the IAIS Executive Committee emphasized that Japan has been playing a leading role in this work. The IAIS issued a report last November which noted that the issue of the protection gap has become more important. Insurers and the supervisors need to think about how to address this issue, given its societal role. The report highlights that, while there are differences of mandates among supervisors, they have a role to play in narrowing the natural catastrophe protection gap, citing the potential impact on financial stability, policyholder protection and financial inclusion.

The IAIS's report highlights five roles that supervisors can play. This encompassed assessing the gap, improving financial literacy and risk awareness, incentivising risk prevention and reduction, creating an enabling regulatory and supervisory environment to support the availability of insurance and uptake of coverage, and advising stakeholders on how public and private sectors can partner to narrow the gap.

5. Improved data and a comprehensive disaster risk assessment are key.

5.1 A comprehensive disaster risk assessment including the financial impacts on public finances is necessary to establish coherent resilience strategies

An official commented that disasters have no borders. Like with environmental, social and governance (ESG), it is important to have international standards and dialogue of cooperation. Last year, the OECD issued its Recommendation on Building Financial Resilience to Disaster Risks. This is built on obvious principles for members to put in place the conditions to promote comprehensive disaster risk assessment. Then it is about effectively assessing and managing this risk. There needs to be an understanding of the financial impacts of disasters on public finances in order to help establish coherent strategies for building financial resilience to disasters.

5.2 In some cases, improved data makes it possible to design protection for risks that were previously impossible to insure against

An industry representative stated that, on top of the knowledge that insurance and reinsurance can bring to the table in terms of risk reduction, there is also relevant innovation in the technical field to provide cover in areas where it had not been possible in the past because of a lack of data or a lack of techniques. Regarding public assets, which are typically uninsured in continental

Europe, parametric cover makes it possible now to design insurance protection for the rail or road network, or infrastructure. There is innovation in data analytics and distribution that can be taken advantage of.

6. Public-private partnerships are key to facilitating insurability of hard-to-insure risks

An official noted that a great deal of analysis is also undertaken on insurance and reinsurance. Public-private partnerships (PPPs) in this field are important, not only for tackling losses which can be otherwise uninsurable but for preventative work and exchanging data. Hopefully this will be advanced further in 2024.

A regulator and the Chair of the IAIS voiced their appreciation for the OECD's contribution to the IAIS report, particularly on PPPs. The Japan G7 presidency last year stressed the importance of the IAIS work on nat. cat. protection gap and the Italian G7 presidency is also keen to take up this issue. Japan has always been hit by natural disasters, and its government supports and reinsures earthquake insurance. Work is taking place to form a new organisation to promote financial literacy. Promoting financial literacy in the insurance space could be very important.

An official stated that mutualisation is at the core of what insurance brings to its clients and to society in general. The bigger the pool, the easier to price and lower the premiums. This means the benefit is widely shared. That works well for easy, predictable, and quantifiable risks. However, this is much more difficult in a rising risk situation. There has already been an attempt to strengthen these kinds of mutualisation elements at a national level.

In PPP there are elements for each side to do. On the public side in France, there was first the question of strengthening the existing system, such as reinsurance, that is guaranteed with an unlimited guarantee on the nat. cat. system. Part of it is to ensure mutualisation continues with a basic measure intended to raise the top-up premium that is on every contract in France to pay for stabilisation and the enduring of this mutualisation system. It is also about looking at the elements that are putting mutualisation into jeopardy. One paradox is that better data can be detrimental to mutualisation. Data is getting better and better, but any use of data to do more selectivity and less mutualisation presents a problem.

6.1 Sound assessment, balanced sharing of the cost underlying risks, adaptation, as well as limiting possible moral hazard are prerequisites for a PPP to reduce the insurance gap and dampen disaster negative impacts. Supervisors have a role to play

An industry representative highlighted PPPs as one of the solutions. However, the underlying risk still needs to be priced. PPP encompasses three core ecosystem players, which are authorities, insurers, and the policyholders. All three need to have equal skin in the game because the aim is not to have just an insurance mechanism but to also build resilience. If there is no resilience and there is a continued increase of these losses, the continued viability of the PPP could fall into question.

The Chair commented that it is likely if more data shows that there is more risk the price will go up. Yet, insurers will need to price the risk. So, this is not a problem that can only be solved within the context of the insurance industry.

An industry representative highlighted moral hazard as a major obstacle to increasing insurance penetration. Italy has made a big step in the right direction with the passing of its budget law, Article 24, which makes it very clear that a corporate or an enterprise must have insurance otherwise it will not be reimbursed.

On the public side, particularly in respect of continental Europe, every level of administration tends to pass the risk onto the next higher level of administration. If the higher administrative level bails out the municipality or the Landkreis, there is absolutely no incentive for that municipality to be self-sufficient, self-reliant, and to manage risk accordingly.

A regulator noted that on PPPs, the European Central Bank (ECB) and EIOPA paper was comprehensive, and it touched upon the importance of addressing moral hazards.

He also noted that PPPs can take various forms across jurisdictions. First regarding financial literacy or risk awareness, there is a common goal that the public sector can share with the private sector.

The second area is risk prevention. The role of insurers could be important by-offering risk-based premiums, to incentivise policyholders to be more resilient in terms of their property. The public sector can also help to identify what resilient infrastructure is. They have expertise to point out what kind of infrastructure would be desirable in the future.

The third area is tail risk. What kind of risks the private sector can cover and what would be difficult. There could be tension between the public and the private sectors on how to structure this in the most desirable way for a PPP. There is no one-size-fits-all and there could be jurisdictional differences. Supervisors can play a role by being involved in the design of the PPPs.

6.2 One of the main challenges in setting up PPPs is managing effective public-private discussions: supervisors have a role to play

The Chair stated that supervisors are the catalyst of a public-private discussion that certainly need to take place. The sooner that consumers and industries are back up on their feet and back into economic activity, the less of a second round of effects these events will have. Smaller companies not only want insurers to help them when there is damage, but also to be helped to prevent damage as they lack the knowledge. This is a new area for insurance.

An industry representative stated that the aim is for insurers to raise risk awareness and work on risk prevention. Policymakers are extremely powerful in steering and incentivising collective behaviour. It is helpful to provide understanding of the risks, prevention and mitigation to public authorities, customers, and society. It is not always complicated, but it needs to be clearly shared so public and private are working together to influence and steer customer behaviour.

The Chair summarised that there is increasingly integrated dialogue with key players from the markets, public authorities, and international organisations on how to approach the insurance protection gaps. There is an understanding that individuals need protection, but also societies, and even parts of the world, jointly need mechanisms to deal with these risks. Governments need to tell the policyholders that they should not rely upon help from governments.

Market knowledge, innovation and more data will help the industry to understand more, to do more and to insure things that could not be insured before. Dialogue on PPPs is now taking place in the IAIS, EIOPA, OECD and the ECB. There will continue to be examples and principles for PPPs. This will require a joint approach.

6.3 An EU level mechanism addressing possible insurance market failures may help to reinforce national (normally) self-sufficient PPPs

An official stated that, while the EU level is also very important and could present a solution, it must be targeted at the last resort. That means that national levels should be developed, functioning and self-sufficient, and that there is a higher level developed for specific cases, such as very high impact transnational events and when there is a demonstrated market failure, because it is known that some elements of risk have chased private reinsurance from some risks.